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INFO RUCNSAD/SOUTHERN AFRICAN DEVELOPMENT COMMUNITY
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RUCPDC/DEPT OF COMMERCE WASHDC
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SIPDIS

DEPT FOR AF/S/MTABLER-STONE; AF/EPS; EB/IFD/OMA
USDOC FOR 4510/ITA/MAC/AME/OA/DIEMOND
TREASURY FOR OAISA/RALYEA/CUSHMAN
USTR FOR COLEMAN

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SUBJECT: SOUTH AFRICA ECONOMIC NEWSLETTER JANUARY 13 2006
ISSUE

11. Summary. Each week, Embassy Pretoria publishes an economic newsletter based on South African press reports. Comments and analysis do not necessarily reflect the opinion of the U.S. Government. Topics of this week's newsletter are:

- Manufacturing Production Growth Recovers;
 - Housing Prices Continue to Slow;
 - Credit Demand Slows;
 - Trade Deficit Narrows;
 - Transnet's Credit Risk from Zimbabwe Parastatals Low;
 - Reserves Above \$20 Billion
 - Business Confidence at 2005 Peak;
 - SA's Online Spending Increased 20%;
 - SA Vehicle Sales Increase 28.5% in 2005; and
 - High School Dropout Rate High
- End Summary.

Manufacturing Production Growth Recovers

12. In November, South Africa's manufacturing output rose by 3.7% (y/y in volume terms, not seasonally adjusted), compared to October's yearly rise of 0.3% according to Statistics South Africa (StatsSA). On a monthly basis, manufacturing production rose by 2.1%. Using a year to date basis, manufacturing production increased by 3.2%, giving a better indication of overall 2005 growth. Seven out of ten manufacturing sectors experienced positive quarterly growth. The major contributors to increased growth included the basic iron and steel, non-ferrous metals and metal products and machinery sectors, followed by motor vehicles sector. The petroleum, rubber, plastics and chemical sector accounted for most of the negative growth in sectors because of petroleum industry changing to lead free fuel, followed by production decline in food and beverages. Manufacturing is the second-biggest sector (after the service sector) in South Africa, accounting for more than 16% of the economy. Recent strengthening of the rand poses potential risks to the manufacturing recovery, especially if consumer demand softens. In recent trading, the rand traded just under 6 rands per dollar. Source: Reuters and Statistics SA Release P3041.2, January 12.

Housing Prices Continue to Slow

13. In December 2005, nominal housing prices continued their slowing trend, reaching 14.7% increase compared to a

30.8% increase at the beginning of 2005. The rate of nominal house price growth peaked in September and October 2004 at 35% and has since declined steadily. According to ABSA bank housing surveys, the average house price in 2005 was R700,200 (\$110,100, using 6.36, the 2005 average rand/dollar exchange rate) compared to 2004's average house price of R574,200 (\$89,000, using 6.45, the 2004 average rand/dollar exchange rate). The 2005 growth in mortgages reached 27% and 2006's growth is expected to be 20%-22%, along with a growth in real disposable income at 6%, according to ABSA senior economist Jacques Du Toit. Adrian Saville, chief investment officer at Cannon Asset Managers asserted that residential property remained an overvalued asset and vulnerable to interest rate increases, although risks of interest rate hikes remain low due to slowing in inflation, money supply and credit growth. Source: Business Day, January 12.

Credit Demand Slows

¶4. November's demand for credit by the private sector reached 18.8% (y/y), slower than October's growth of 19.3%. The broadly defined M3 measure of money supply grew by 16.4%, below forecasts, after increasing by 15.9% in October. Consensus forecasts expected private sector credit demand and M3 to increase by 18.6% and 17.3%, respectively. The strong demand for private sector credit in 2005 has fueled strong growth in domestic expenditures, leading to an expected 2005 GDP growth of over 5%. Source: Business Day, December 30.

Trade Deficit Narrows

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¶5. According to the South African Revenue Service, November's trade deficit narrowed compared to October due to strong growth in exports. The trade deficit narrowed to R3.1 billion from October's R5.5 billion, with exports and imports increasing by 17.1% and 6.4%, respectively. Exports showing the strongest November growth include: vehicles, aircraft and vessels, jewelry, base metals, machinery and electrical appliances and minerals. Nedbank economist Magan Mistry said the deficit exceeded market expectations of R2 billion. The cumulative deficit for the period from January to November in 2005 was R24.9 billion, compared to R15.3 billion for the same period in ¶2004. Standard Bank economist Johan Botha said the cumulative deficit had raised fears that the current account deficit might increase from 4.7% of GDP to more than 5%. Source: Business Day, December 30.

Transnet's Credit Risk from Zimbabwe's Parastatals Low

¶6. According to Public Enterprises Minister Alec Erwin, Zimbabwean utility companies owed Transnet R28.7 million (\$4.8 million, using 6 rands per dollar) in September but only 0.03%, or R949,000 (\$158,167), would not be repaid. Transnet was exposed to credit risk from more than one Zimbabwean parastatal. Air Zimbabwe owed a monthly balance of R530,000 (\$88,330) and the National Railways of Zimbabwe (NRZ) was in a net credit position. Transnet did not grant a credit line beyond the standard over-border account between NRZ and Transnet. When Transnet agreed to buy fuel for NRZ, the value was limited to the monthly over-border account to ensure settlement within 30 days. Zesa, the Zimbabwean electricity utility, settled its debt, ranging from R138 million (\$23 million) to R14 million (\$2.3 million), to Eskom by May 2005. Source: Business Day, January 6.

Reserves Above \$20 Billion

¶17. The South African Reserve Bank (SARB) increased its December foreign reserves to \$664 million compared to a \$125 million increase in November so that its gross foreign and gold reserves exceeded \$20 billion for the first time. Economists view \$20 billion as a minimum safety cushion and many economists expect SARB's foreign reserve buying to continue, given continuing high commodity prices and rand strength. In August 2005, two ratings agencies (Standard & Poor's, as well as Fitch) upgraded South Africa's foreign currency rating to BBB plus, in part because of the Bank's accumulation of foreign reserves, leading to an improvement in South Africa's ability to repay foreign debt. Up until February 2004, the foreign exchange reserves had fluctuated around the \$6 billion since 1999, but then rose to \$8.3 billion in March and have risen steadily since. Although the value of reserves increased 3.7% from \$19.9 billion in November to \$20.7 billion by December, reserves are now equal to 3.8 months' import cover, lower than the international standard of six months. Source: INET, Business Day, January 9; Business Day, January 10.

Business Confidence at 2005 Peak

¶18. The South African Chamber of Business's (Sacob) business confidence index reached its 2005 peak in December due to stable interest rates and an optimistic inflation outlook. December's Sacob business confidence index rose to 129.4 points, up from 126.5 in November. During 2005, business confidence averaged 127.1 points, compared with 124.4 in 2004. Sacob economist Richard Downing cited strong domestic economic activity as enhancing business confidence but warns about increasing current account deficits as possible risks to the business confidence outlook. The current account deficit, at 4.7% of GDP in the third quarter of 2005, far higher than the "ideal" 3%, is expected to stabilize at about 4% in 2006. Downing said that in order for business confidence to continue to be positive, the rand had to remain strong to prevent serious inflationary consequences, but not so high as to dampen the export sector. Sacob also attributed the rise in confidence last month to the rise in gold and platinum prices. Recently gold prices reached a 24-year

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peak of \$537/oz, while platinum peaked at \$1014/oz on strong demand and supply constraints. The metals account for about 20% of South African exports. Source: Business Day, January 6.

SA's Online Spending Increased 20%

¶19. South Africans spent R514 million (\$86 million) shopping online in 2005, 20% higher than 2004, according to a report by research firm World Wide Worx. The 2005 total did not include 2005 online air ticket sales of R1.8 billion (\$300 million) compared to its 2004 total of R850 million (\$142 million). The 2005 online retail shopping growth was lower than the 2004 growth of 25%. The survey of 800 online retail outlets cited lack of speed in internet access and affordable access to broadband as the biggest obstacles to growth in online sales. The online retail market was dominated by 10 online retail sites: M-Web ShopZone and Digital Mall, online grocers Pick 'n Pay Home Shopping and Woolworths, book retailers Kalahari.net and Exclusive Books, florist NetFlorist, wine retailer Cybercellar, electronics store Digital Planet, and health and beauty store Ascot Direct. World Wide Worx expects a further 20 percent increase in online retail shopping in ¶2006. Research firm BMI-TechKnowledge expects broadband users to increase to 870,000 in the next five years from 40,000 in 2005, on expectations of lower internet access prices. The number of online retail sites has grown from

719 at the end of 2003 to 826 in 2005. The fastest-growing major categories were auctions, gifts and apparel. Source: Business Report January 10.

SA Vehicle Sales Increase 28.5% in 2005

¶10. South Africans bought more new vehicles in 2005 than in any previous year, according to sales figures released by the National Association of Automobile Manufacturers (NAAMSA). New vehicle sales (including cars, trucks and buses) reached R125 billion (\$21 billion) in 2005 compared to R96 billion (\$16 billion) in 2004. Domestic vehicle sales figures for 2005 increased 28.5% to almost 617,500 units, double the number of new vehicles sold five years ago, and higher than the previous record of 482,000 units in 2004. Sales figures compiled by NAAMSA include NAAMSA and non-NAAMSA members, accounting for 8% of South Africa's market. Lower interest rates and growing middle class were credited as the major stimulus behind record car sales. McCarthy chairman Brand Pretorius estimated that McCarthy, South Africa's largest dealer network, sold one of every four or five new cars, and one out of every three used cars, to black customers. It now took an average South African household in the living standard measure 10 category (average monthly income of R18,822 or \$3137) about 37 weeks' earnings to buy a car, compared to 71 weeks three years ago. NAAMSA has not yet totaled its export figures but estimates that approximately 145,000 vehicles were exported in 2005, up from the 110,507 vehicles exported in 2004. The vehicle industry contributes about 7.4% to GDP. Source: Business Day, January 11.

High School Drop Out Rate High

¶11. Less than half of South Africa's grade 10 students in 2003 took their high school graduation (matric) exams two years later. In 2005, 508,363 students took the exams in grade 12, although 1,096,214 students were registered as grade 10 students in 2003. While 347,184, or 68% of students who took the exam passed in 2005, when calculated as a percent of the 2003 grade 10 class, only 32% of students graduated and 587,851 dropped out of school. Teacher unions had asked for more research about the increased dropout rate in high schools but little has been released. Source: Business Day, January 11.

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